Report

of the

Examination of

Cities and Villages Mutual Insurance Company

Brookfield, Wisconsin

As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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April 5, 2005

Honorable Jorge Gomez
Secretary, Midwestern Zone, NAIC
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

CITIES AND VILLAGES MUTUAL INSURANCE COMPANY
Brookfield, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Cities and Villages Mutual Insurance Company (the company) was conducted in 1999 as of December 31, 1998. The current examination covered the intervening period ending December 31, 2003, and included a review of such 2004 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The company was organized in 1987, as Cities and Villages Mutual Insurance Company (CVMIC). In order to facilitate CVMIC's formation, financing, and governance, the Commissioner, pursuant to s. 611.23, Wis. Stat., relaxed CVMIC's organization requirements. Section 611.23, Wis. Stat., further exempts CVMIC from chs. 604 to 607, 612 to 619, 625, and 646, Wis. Stat., because those chapters' provisions were considered unnecessary for the protection of the interests of municipalities and their citizens.

CVMIC was formed in 1987 by 20 municipalities to provide liability insurance for municipal operations. It was originally capitalized with $25 million in taxable revenue bonds issued by Wisconsin Municipal Insurance Commission (WMIC), a joint powers authority, organized under s. 66.30, Wis. Stat. WMIC's bonds were collateralized by general obligation bonds issued by the member municipalities. WMIC issued $22.8 million taxable revenue refunding bonds in 1997 to take advantage of favorable interest rates. Scheduled payoff of the bonds is in 2007.

CVMIC pays investment earnings (as policyholder dividends) to participating municipalities, on a pro rata basis in relation to their general obligation bonds contributed, to enable them to reduce or eliminate the need to collect levied property taxes for their general obligation bonds.

New municipality admission is subject to certain conditions as defined by the participating members. A new municipality may be required to make a capital contribution to CVMIC or pay an annual fee or surcharge in lieu of such a contribution. Currently, there are 40 member municipalities. The last 4 members to join CVMIC have not made a capital contribution. In place of the contribution, the members are paying a surcharge which is a 20% increase on premium. The members will pay the surcharge until the amount of the surcharge is equivalent to what the capital contribution would have been.

CVMIC writes municipal liability insurance, including general liability, public officials' liability, law enforcement liability, worker's compensation and commercial auto liability coverage to member municipalities in the state of Wisconsin. Extensive loss control procedures and risk management services are an integral part of the company's operating philosophy. For liability policies CVMIC provides coverage of $2 million in excess of each member's self-insured retention (SIR). These SIRs range from $10,000 to $175,000. A group purchase is made for $8 million coverage excess the $2 million provided by the company. As a risk management service to its members, the company provides auto physical damage, boiler and machinery, excess worker's compensation and excess liability coverage through group purchase arrangements with other insurance carriers.

All business is produced on a direct basis. Policies are assessable for up to 125% of the annual premium. Effective January 1, 1998, the company offered worker's compensation coverage to members. Currently, 24 of the member municipalities participate in the coverage of worker's compensation.

CVMIC also offers third-party worker's compensation claim administration services to five of its members. Separate service fees for each indemnity claim and each medical claim are billed to the member. Claims that were reported to a previous third-party administrator and later administered by CVMIC are billed lesser fees for the life of the file.

In Wisconsin, municipalities have limited exposure to large general liability and automobile claims, due to a tort cap of $50,000 in indemnity losses for general liability, $250,000 for automobile liability, and $150,000 for wrongful death. This tort cap does not apply to the miscellaneous liability coverage or for federal cases.

The company writes direct premium only in the state of Wisconsin. CVMIC is not authorized to write business in other states.

Organizational Objectives

The company was organized to provide a long-term solution to municipal liability insurance programs. Advantages of the program, which are cited by the company in comparison with purchasing commercial insurance by individual cities and villages, include the following:

1) To charge relatively level premiums, thereby protecting municipalities from commercial insurance pricing cycles.

2) A cost saving resulting from the elimination of insurance company profits and insurance agent commissions and fees.

3) Members of a pooled liability program with a significant loss reserve will be in better position to negotiate with commercial insurance companies for purchase of excess insurance or reinsurance.

4) The municipalities will hope to better meet their liability insurance needs by controlling their own insurance program.

5) Provide municipalities with a means of formal training on risk management concerns.

The company has established underwriting and claims administration standards and liability claims control quality guidelines. Failure of a municipality to follow such standards and guidelines, or failure to pay premium when due may, under certain circumstances, result in cancellation of coverage.

The following table is a summary of the net insurance premiums written by the company in 2003. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	**Direct Premium**	**Reinsurance Assumed**	**Reinsurance Ceded**	**Net Premium**
Worker's compensation	$4,451,793	$	$	$4,451,793
Other liability – occurrence	2,733,092			2,733,092
Commercial auto liability	911,031			911,031
Total All Lines	$8,095,916	$	$	$8,095,916

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of seven members. Each year, three directors are elected to serve a two-year term and one at-large director is elected to serve a one-year term. The three directors elected for a two-year term represent one from each of the three classes of municipalities. A Class One director represents a municipality with a population in excess of 50,000, a Class Two director represents a municipality with a population in excess of 15,001 through 50,000, and a Class Three director represents a municipality with a population less than 15,001. An at-large director is elected from all members without regard to population. All members vote for all seats on the board of directors.

Officers are elected at the board's annual meeting. Directors are reimbursed for travel expenses for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Ronald George Braier Wauwatosa, WI	Comptroller	2006
Dale Darling Wisconsin Dells, WI	City Clerk/Treasurer & Controller	2005
Russ Van Gompel Germantown, WI	Village Administrator	2005
Margaret Ruth Powers Sun Prairie, WI	Asst. City Administrator/Financial Director	2005
Gary Grant Rogers Waupun, WI	City Administrator	2006
Herbert Herman Stinski Milton, WI	Finance Director	2006
Paul Michael Ziehler West Allis, WI	City Administrative Officer	2005

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2003 Compensation
Paul Michael Ziehler	President	$ 0
Ronald George Braier	Secretary/Treasurer	0
Herbert Herman Stinski	Vice President	0
Michael Leroy DeMoss	Executive Director	119,724
Kenneth Allen Horner	Director of Operations	114,901

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The bylaws allow for the president to appoint representatives to serve on each committee and to also appoint a member of the board of directors to serve as a liaison to a committee but without voting privileges. The committees at the time of the examination are listed below:

Finance Committee
Dave Berner, Monona
Ron Braier, Wauwatosa*
Fred Buehler, Onalaska
Mike Easker, Neenah
Patricia Huberty, Plymouth
John Neal, Stoughton
Robert Scott, Brookfield
Sam Tapson, Elkhorn
Jim Villiesse, New London

Claims Committee
Mary Lou Andersen, Superior
Mike Ciaramita, Beloit
Barbara Limpert, Appleton
Richard Maslowski, Glendale
Joseph Murray, Greendale
Philip Parkinson, Rhinelander
Margaret Powers, Sun Prairie*
Daniel Wright, Racine
James Wyss, Manitowoc

Underwriting/Member Services Committee
Barbara Bumenfield, Oak Creek
Dale Darling, Wisconsin Dells*
Richard Gebhart, Sheboygan
Edward Geick, Baraboo
James Grassman, Whitefish Bay
Joe Henika, Cudahy
Gary Koppelberger, Hartford
Kaye Matucheski, Antigo
Tamara Mayzik, South Milwaukee
James Myers, Monroe
Tamara Potkay, New Berlin

Personnel Committee
Jeff Brandt, Menasha
Jim Geissner, La Crosse
Rick Hermus, Kimberly
Peter Masias, Green Bay
Christine Peplin, Menomonee Falls
Gary Rogers, Waupun*
Steve Stanczak, Kenosha
Russ Van Gompel, Brown Deer

*Board Liaison

IV. AFFILIATED COMPANIES

Wisconsin Mutual Insurance Commission

WMIC, a joint powers authority, pursuant to s. 66.30, Wis. Stat., was formed for the purpose or providing financing for CVMIC. WMIC provided the funding to CVMIC in the form of taxable revenue refunding bonds of $25 million. General obligation bonds of the members collateralize the taxable revenue refunding bonds.

All CVMIC members are WMIC members. CVMIC and WMIC also have a common board of directors with the board meeting of one following the board meeting of the other. WMIC's board of directors' meetings generally address bond-related issues. CVMIC incurs expenses on behalf of WMIC and provides personnel and administrative services to WMIC without reimbursement. The company estimates the expenses incurred to be under $10,000 a year.

The relationship between CVMIC and WMIC resembles that of an insurance holding company system. However, s. 611.23, Wis. Stat., exempts CVMIC from ch. 617, Wis. Stat. Therefore, CVMIC is not required to file a holding company registration statement with the Commissioner.

V. REINSURANCE

In 1998 CVMIC began to write worker's compensation and employers' liability insurance. As part of this program an excess liability insurance policy for worker's compensation and employers' liability insurance was purchased, which provides CVMIC protection for the member municipalities that participate. The previous examination report noted that the purchased policies are direct policies, and that the company should not report them as reinsurance. The current examination noted that the policies in effect at year end 2003 were still direct policies. These are being written up in the "Reinsurance" section of the report due to the expectation that they should function similar to reinsurance.

The company's reinsurance portfolio and strategy is described below.

1)	Type:	Excess Public Entity Liability	
	Insured:	Cities and Villages Mutual Insurance Company and its Member Cities and Villages	
	Insurer:	Insurance Company of the State of Pennsylvania (ISOP)	
	Scope:	Liability by contract for Bodily Injury, Personal Injury, Property Damage or Public Officials Errors & Omissions	
	Retention:	$2,000,000 Each Occurrence	
	Coverage:	$8,000,000 Each Occurrence	
	Premium:	Based on annual payroll of member municipalities at the rate of $.9783 per $1,000	
	Effective:	January 1, 2004, to December 31, 2004	
2)	Type:	Excess Worker's Compensation & Employers' Liability	
	Insured:	Cities and Villages Mutual Insurance Company	
	Insurer:	Safety National Casualty Corporation	
	Scope:	Worker's compensation and employers' liability insurance written by the company	
	Retention:	$350,000 Each Occurrence	
	Coverage:	Worker's Compensation	Statutory
		Employers' Liability	$100,000 each accident, $1,000,000 policy limit, $1,000,000 each employer

Premium:	Based on annual payroll of member municipalities at the rate of $.1538 per $100
Effective:	January 1, 2004, to December 31, 2004

CVMIC is also involved in several group purchases programs for its member municipalities. These programs include excess liability coverage of $5 million over the CVMIC program with the ISOP in a policy written for WMIC. WMIC also offers automobile physical damage protection for all members and excess worker's compensation and employers' liability coverage for self-insured members.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

CVMIC
Assets
As of December 31, 2003

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$27,718,446	$	$27,718,446
Stocks:			
Common stocks	1,995,758		1,995,758
Real estate:			
Occupied by the company	811,558		811,558
Cash	1,825,305		1,825,305
Short-term investments	4,055,327		4,055,327
Investment income due and accrued	284,491		284,491
Electronic data processing equipment and software	143,565	143,565	
Furniture and equipment, including health care delivery assets	57,038		57,038
Other assets nonadmitted:			
Write-ins for nonadmitted assets:			
Nonadmitted furniture and fixtures	26,300	26,300	
Write-ins for other than invested assets:			
Receivables from policyholders	49,379		49,379
Total Assets	$36,967,167	$169,865	$36,797,302

CVMIC
Liabilities, Surplus, and Other Funds
As of December 31, 2003

Losses		$ 6,678,217
Loss adjustment expenses		1,389,754
Other expenses (excluding taxes, licenses, and fees)		29,572
Unearned premiums		2,242,960
Dividends declared and unpaid:		
Policyholders		2,002,128
Amounts withheld or retained by company for account of others		22,257
Total Liabilities		12,364,888
Write-ins for special surplus funds:		
Refundable restricted surplus contribution	$25,000,000	
Unassigned funds (surplus)	(567,586)	
Surplus as regards policyholders		24,432,414
Total Liabilities and Surplus		$36,797,302

CVMIC
Summary of Operations
For the Year 2003

Underwriting Income		
Premiums earned		$6,958,098
Deductions:		
Losses incurred	$2,601,693	
Loss expenses incurred	1,351,173	
Other underwriting expenses incurred	1,592,307	
Total underwriting deductions		5,545,173
Net underwriting gain or (loss)		1,412,925
Investment Income		
Net investment income earned	1,571,653	
Net realized capital gains or (losses)	(164,683)	
Net investment gain or (loss)		1,406,970
Other Income		
Write-ins for miscellaneous income:		
Miscellaneous income	172,338	
Total other income		172,338
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		2,992,233
Dividends to policyholders		3,752,943
Net Loss		$ (760,710)

CVMIC
Cash Flow
For the Year 2003

Premiums collected net of reinsurance			$8,095,916
Net investment income			1,406,972
Miscellaneous income			172,338
Total			9,675,226
Benefit and loss related payments		$3,326,165	
Commissions, expenses paid, and aggregate write-ins for deductions		1,692,312	
Dividends paid to policyholders		3,672,511	
Total deductions			8,690,988
Net cash from operations			984,238
Proceeds from investments sold, matured, or repaid:			
Bonds	$9,842,335		
Stocks	459,583		
Total investment proceeds		10,301,918	
Cost of investments acquired (long-term only):			
Bonds	8,516,647		
Stocks	405,992		
Real estate	111,599		
Total investments acquired		9,034,238	
Net cash from investments			1,267,680
Reconciliation			
Net change in cash and short-term investments			2,251,918
Cash and short-term investments, December 31, 2002			3,628,714
Cash and short-term investments, December 31, 2003			$5,880,632

CVMIC
Compulsory and Security Surplus Calculation (in thousands)
December 31, 2003

Assets		$36,797,302
Less liabilities		12,364,888
Adjusted surplus		24,432,414
Annual premium:		
Lines other than accident and health	$8,095,916	
Factor	20%	
Compulsory surplus (subject to a minimum of $2 million)		2,000,000
Compulsory surplus excess (or deficit)		$22,432,414
Adjusted surplus (from above)		$24,432,414
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		2,800,000
Security surplus excess (or deficit)		$21,632,414

CVMIC
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2003	2002	2001	2000	1999
Surplus, beginning of year	$24,904,123	$25,747,471	$25,724,315	$25,279,843	$25,115,246
Net income	(760,710)	(525,071)	(46,104)	401,361	207,380
Net unrealized capital gains or (losses)	438,689	(93,370)			
Change in non-admitted assets	(149,688)	4,523	5,260	7,111	5,217
Change in provision for reinsurance				36,000	(48,000)
Cumulative effect of changes in accounting principles			64,000		
Write-ins for gains and (losses) in surplus: Debt Service Payment		(227,430)			
Surplus, end of year	$24,432,414	$24,904,123	$25,747,471	$25,724,315	$25,279,843

CVMIC
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2003

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	2003	2002	2001	2000	1999
#1	Gross Premium to Surplus	33%	25%	18%	19%	18%
#2	Net Premium to Surplus	33	25	18	19	18
#3	Change in Net Writings	32	36*	-10	9	2
#4	Surplus Aid to Surplus	0	0	0	0	0
#5	Two-Year Overall Operating Ratio	105*	104*	98	91	95
#6	Investment Yield	4.4*	5.9	6.2	7.3	7
#7	Change in Surplus	-1	-3	-1	2	1
#8	Liabilities to Liquid Assets	34	31	28	29	28
#9	Agents' Balances to Surplus	0	0	0	0	0
#10	One-Year Reserve Development to Surplus	-4	-4	-5	-2	-3
#11	Two-Year Reserve Development to Surplus	-6	-9	-9	-6	-5
#12	Estimated Current Reserve Deficiency to Surplus	-2	-5	-5	-1	3

Ratio Number 3, Change in Net Writings, measures the increase or decrease in reported net premium written as a percentage of net premiums written in the prior year. For 2002 the company reported significant increases in net premium written, due to a combination of an increase in the number of members with worker's compensation contracts and rate increases causing an exceptional IRIS ratio.

Ratio No. 5 measures the company's profitability over the previous two-year period. Ratio No 5 is measured after policyholder dividends. The company has paid policyholder dividends in excess of $3.0 million each year since the last examination. The average combined ratio for the past six years is approximately 75% showing the company has favorable underwriting results. In 2002 and 2003, the company reported net losses mainly attributable to the high policyholder dividends paid resulting in the exceptional ratio.

Ratio number 6, Investment Yield, measures net investment income as a percentage of the average amount of cash and invested assets during the year. The exceptional result in 2003 reflects the relatively low investment yield environment that prevailed in the financial market.

Growth of CVMIC

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Policyholder Dividend	Net Income
2003	$36,797,302	$12,364,888	$24,904,123	$3,672,511	$(760,710)
2002	35,688,636	10,784,513	25,747,471	3,577,218	(525,071)
2001	35,846,523	10,099,051	25,724,318	3,547,711	(46,104)
2000	36,311,202	10,586,886	25,279,843	3,310,815	401,361
1999	34,952,077	9,672,234	25,167,246	3,348,860	207,380
1998	35,992,503	10,825,256	25,167,246	3,091,821	164,494

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2003	$8,095,916	$8,095,916	$6,958,098	56.8%	17.5%	74.3%
2002	6,114,416	6,114,416	5,826,229	54.4	21.1	75.5
2001	4,509,599	4,509,599	5,411,891	51.9	26.8	78.7
2000	4,985,899	4,985,899	4,503,245	46.4	22.5	68.9
1999	4,556,530	4,556,530	4,336,371	46.3	24.1	70.4
1998	4,468,621	4,468,621	4,343,272	60.8	21.6	82.4

The company began offering worker’s compensation coverage in 1998 which has contributed to the increase in net premium written and the loss ratio. Growth of the company resulting in an additional line of business creates significantly more data for the company to retain and process. The number of members remained unchanged during the years under examination. The net losses reported for the past three years were mainly due to dividends being paid to the company’s members.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2003, is accepted.

Examination Reclassifications

	Debit	Credit
Unearned Premium	$2,242,960	$
Advance Premiums		2,242,960

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were seven specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. **Board Committees**—It is recommended that the company comply with s. 611.56, Wis. Stat., as regards membership of committees.

   Action—Partial compliance, see comments in the summary of current examination results.

2. **Accounts and Records**—It is again recommended that the company: (1) reconcile its checking accounts to company book balances monthly; and (2) follow up on all unreconciled items and resolve any problems found.

   Action—Compliance

3. **Accounts and Records**—It is recommended that the company record funds held in a fiduciary capacity, such as payroll taxes, as "amounts withheld or retained by the company on account of others' in accordance with the NAIC Annual Statement Instructions-Property and Casualty.

   Action—Compliance

4. **Accounts and Records**—It is recommended that amounts payable for purchase program expenses paid for WMIC (its affiliate) be shown as a separate write-in liability, and that expenses paid for WMIC be shown as separate write-in expense in Part 4 of the Underwriting and Investment Exhibit.

   Action—Compliance

5. **Reinsurance Premium Ceded**—It is recommended that the company report reinsurance transactions on Schedule F – Parts 3 and 8, Schedule P, and the Underwriting and Investment Exhibit Part 2B, in accordance with the NAIC Annual Statement Instructions-Property and Casualty.

   Action—Compliance

6. **Losses – Schedule P Reporting**—It is recommended that the company accurately report loss and loss adjustment expense payments and reserve amounts in Schedule P as prescribed by NAIC Annual Statement Instructions, and that an audit trail be maintained to reconcile Schedule P data to company records.

   Action—Noncompliance, see comments in the summary of current examination results.

7. **Losses – Schedule P Reporting**—It is recommended that the company retain records of operations and other financial records reasonably related to insurance operations, including year-end computer reports, for at least 3 years and until the next examination of the company, pursuant to s. Ins 6.80 (4) (c), Wis. Adm. Code.

   Action—Compliance

Summary of Current Examination Results

Board Committees

It was noted during the examination that the company has appointed four committees. Most committee members are not directors. All four committees have a board liaison. Section 611.56 (1), Wis. Stat., notes that each committee should consist of at least three directors serving at the pleasure of the board. There was a recommendation in the prior report that the company comply with s. 611.56, Wis. Stat. The company had amended their by-laws to comply. This change in by-laws did not bring the company into compliance. Thus, it is again recommended that the company comply with s. 611.56, Wis. Stat., as regards membership of committees.

Bonds

It was noted during the examination that there were a number of errors on Schedule D of the annual statement:

- The settlement date was used in Schedule D instead of the trade date as required by annual statement instructions. Public placements are to use the trade date.
- Schedule D - Part 1 does not agree with Schedule D - Part 1A - Section 2 for the type of bond. Schedule D - Part 1 reports bonds in three sections, while Part 1A - Section 2 reports all bonds in one section.
- The effective rate of interest is not shown for bonds in Schedule D – Part 1; prior to 2003 it was included.

It is recommended that the company complete Schedule D in accordance with the NAIC Annual Statement Instructions - Property & Casualty.

Custodial Agreement

It was noted that the company had a custodial/safekeeping agreement with their broker at year end 2003. In 2004, the company terminated the agreement with the broker and entered into an agreement with a bank. A bank currently holds the company's securities under the safekeeping agreement. However, the agreement did not contain satisfactory safeguards and controls as specified in the National Association of Insurance Commissioners' (NAIC) Examiners Handbook. Guidance was provided to the company during the examination of the appropriate controls and safeguards required by the NAIC Financial Examiner's Handbook. It is recommended that the company amend their custodial/safekeeping agreements to have the proper controls and safeguards pursuant to the language suggested by the NAIC Financial Examiner's Handbook.

Real Estate

The examination also noted a number of errors in reporting for the real estate:

- The company did not enter real estate expenses or repairs in Schedule A.
- The company did not include rent for the home office in Schedule A as income. The NAIC Annual Statement Instructions - Property & Casualty require that the company include in both its income and expenses an amount for rent relating to its occupancy of its own buildings. The amount recorded shall be at a rate comparable to rent received from others and/or rental rates of like property in the same area.
- The cost of the building includes the value of the land. Per SSAP No. 40, paragraph 8, land is not to be depreciated. The company has been depreciating land.

It is recommended that the company complete Schedule A in accordance with the NAIC Annual Statement Instructions - Property & Casualty.

- The company is not listing the real estate expenses or repairs on the line for 'Real estate expenses' in Part 3 - Expenses of the Underwriting and Investment Exhibit.
- The company did not include rent for the home office as income in the 'Exhibit of Net Investment Income' and expenses in Part 3 - Expenses Underwriting and Investment Exhibit.

It is recommended that the company complete Part 3 – Expenses of the Underwriting and Investment Exhibit in accordance with the NAIC Annual Statement Instructions - Property & Casualty.

Third-Party Administrator (TPA)

During the examination it was noted that the company is a TPA for some of the municipalities. The commissions and reimbursements paid by the municipalities to CVMIC for providing administrative services are recorded as miscellaneous income. In accordance with SSAP No 47, paragraph 6, commissions and expenses should be recorded on a gross basis by type of expense. Where the only functions provided are administrative, administrative fees and related reimbursements from the plan shall be deducted from general expenses. It is recommended that the company report administrative fees and related reimbursements from TPA programs in accordance with SSAP No. 47, paragraph 6.

Software

The examination noted software and EDP equipment were reported on the “Furniture and equipment, including health care delivery assets” line of the Asset page. These balances should have been included in the “Electronic data processing equipment and software” line of the Asset page. In addition, it was noted that the company is admitting non-operating software. In accordance with SSAP No. 16, paragraph 2, software with the exception of operating software is nonadmitted. It is recommended that the company nonadmit non-operating software in accordance with SSAP No 16, paragraph 2, and that the company report all EDP equipment and software on the appropriate line of the Asset page.

Advance Premium

The examination noted that the company recorded premium received for 2004 in 2003 as unearned premium on the annual statement. This balance should be recorded on the advance premium line of the annual statement. Advance premium should be excluded from unearned premium reserves in accordance with SSAP No. 53, paragraph 13. An examination reclassification of $2,242,960 was made from unearned premium to advance premiums. It is recommended that the company report premiums received for a future year as advance premium on the annual statement in accordance with SSAP No. 53, paragraph 13.

Losses

The examination noted that the company does not perform a formal reconciliation between the company’s cash records and claim records at year-end. During the examination, an attempt was made to trace cash payments to the claims documentation. Three separate totals were derived for the 2003 claim payment amount when attempting this reconciliation: one total came from cash disbursements, one from the general ledger, and one from the change in Schedule P amounts. The three separate numbers differed by an immaterial amount, though with time this difference could grow and become a material issue. It was also noted that the incurred date reported in the cash records appears to be incorrect. A sample of claim payments were selected from the cash records; one third of the sample had an incorrect incurred date because the company had instead listed the data entry date. The company has already taken steps to assure that the correct incurred date is entered going forward. A reconciliation between the company's cash records and claim records would have noted this difference. Timely reconciliations are an essential element of an adequate control environment to ensure claim payments are properly maintained and accounted for. It is recommended that the company perform formal reconciliations of cash records to claim records on a monthly basis.

It was also noted during the examination that the company stopped reporting paid Adjusting and Other expenses in Schedule P, Part 1, beginning with the 2002 annual statement. The company includes all expenses under Defense Cost and Containment column. It is necessary for the correct data to be included in Schedule P for the actuary to review and set appropriate reserves as well as appropriate pricing going forward. A recommendation was made in the prior report regarding the reporting of losses and loss adjusting expense (LAE). It is again recommended that the company accurately report loss and LAE payments and reserve amounts in Schedule P, and that an audit trail be maintained to reconcile Schedule P data to company records.

Management and Control

The company averages paying approximately 20 claims per year for auto liability and general liability. The number of claims that are part of the member's self-insured retention related to auto and general liability that are reviewed and tracked by management average approximately 1,400 per year. Worker's compensation currently averages approximately 1,000 claims per year over the first five years of underwriting. Due to the additional transactions resulting from offering worker's compensation coverage and the discrepancies noted above in this section; additional staff is necessary to accommodate the work load and to ensure accuracy. Therefore, it is recommended that the company establish a financial director position to oversee company systems and to ensure the accuracy of the financial statements reported to this office.

VIII. CONCLUSION

The company has generally shown stable operating results and adequate reserves in the past five years. The company has paid policyholder dividends in excess of $3 million each year since the last examination. The company has paid a total of $17,457,115 in policyholder dividends for the past five years. The company provides loss control and risk management services to its membership, and members can obtain other kinds of insurance through group purchase arrangements.

Since the prior examination the company's premium has nearly doubled. This increase is mainly attributable to the addition of worker's compensation business. Also, due to the new line of business offered, the company has reported a significant increase in the number of claims handled. The company needs to establish a financial director position to oversee the proper handling of current business and additional business received.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Board Committees—It is again recommended that the company comply with s. 611.56, Wis. Stat., as regards membership of committees.

2. Page 23 - Bonds—It is recommended that the company complete Schedule D in accordance with the NAIC Annual Statement Instructions - Property & Casualty.

3. Page 24 - Custodial Agreement—It is recommended that the company amend their custodial/safekeeping agreements to have the proper controls and safeguards pursuant to the language suggested by the NAIC Financial Examiner's Handbook.

4. Page 24 - Real Estate—It is recommended that the company complete Schedule A in accordance with the NAIC Annual Statement Instructions - Property & Casualty.

5. Page 24 - Real Estate—It is recommended that the company complete Part 3 – Expenses of the Underwriting and Investment Exhibit in accordance with the NAIC Annual Statement Instructions - Property & Casualty.

6. Page 24 - Third-Party Administrator—It is recommended that the company report administrative fees and related reimbursements from TPA programs in accordance with SSAP No. 47, paragraph 6.

7. Page 25 - Software—It is recommended that the company nonadmit non-operating software in accordance with SSAP No 16, paragraph 2, and that the company report all EDP equipment and software on the appropriate line of the Asset page.

8. Page 25 - Advanced Premium—It is recommended that the company report premiums received for a future year as advance premium on the annual statement in accordance with SSAP No. 53, paragraph 13.

9. Page 26 - Losses—It is recommended that the company perform formal reconciliations of cash records to claim records on a monthly basis.

10. Page 26 - Losses—It is again recommended that the company accurately report loss and LAE payments and reserve amounts in Schedule P, and that an audit trail be maintained to reconcile Schedule P data to company records.

11. Page 26 - Management and Control—It is recommended that the company establish a financial director position to oversee company systems and to ensure the accuracy of the financial statements reported to this office.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Andrew Fell	Insurance Examiner
Randy Milquet	Examiner - Advanced

Respectfully submitted,

Sarah M. Haeft
Examiner-in-Charge